Factsheet for Canadian Charities
Applying for Publicly-Supported Charity Status in the U.S.

Introduction

There is an important step that Canadian land trusts involved in cross-border conservation gifts may want to take in order to maximize tax benefits for donors and to eliminate potential tax problems for donors. This step is required to meet U.S. tax law requirements for land trusts interested in accepting cross-border transfers of conservation easement or other partial interests in land from the American Friends of Canadian Land Trusts (AF).

Cross-Border Conservation with AF

All gifts of land and certain partial interests in land (such as a conservation easement or a remainder interest for conservation purposes) to AF can qualify for a full income tax deduction against US source income because AF is a US-based charity that is recognized by the Internal Revenue Service (IRS) as a ‘Publicly-Supported Charity.’

For Canadian Land Trusts interested in receiving transfers of land (full fee simple interest) or receiving cash grants from AF, recognition as a ‘publicly-supported charity’ with the IRS is not required.

However, Canadian Land Trusts interested in receiving transfers of conservation easements or remainder interests from AF (so-called “qualified conservation contributions”) must receive a determination from the IRS recognizing the Canadian Land Trust as a ‘Publicly-Supported Charity.’ This is a requirement of the IRS in order for the gift to be (and to remain) deductible against U.S. source income.

What is “Status as a Publicly-Supported Charity” and Why is it Necessary?

For gifts of partial interests in land, such as a conservation easement or remainder interest for conservation purposes, the IRS requires that the gift meet the conditions of a “qualified conservation contribution.” As part of this requirement, the donee of the gift must be a ‘qualified donee’ which includes being deemed by the IRS to be a ‘publicly-supported charity’ as opposed to a private foundation.

In the U.S., there are various types of charitable organizations (501(c)(3) organizations) based on a number of criteria, predominantly sources of funding and geographic location. As determined under the Canada-US Income Tax Treaty, Notice 99-47 states that all Canadian charities automatically

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1 Qualified Conservation Contribution - has the meaning assigned by section 170(h)(1) of the Internal Revenue Code, further qualified by § 1.170A-14 (a) of the Treasury Regulations to Internal Revenue Code section 170 (h); defined as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes.

2 Qualified Donee (IRS) - has the meaning assigned by section 170(h)(3) of the Internal Revenue Code, further qualified by § 1.170A-14(c)(1) of the Treasury Regulations to Internal Revenue Code section 170 (h). The definition includes: a governmental unit described in section 170(b)(1)(A)(v) of the Internal Revenue Code; an organization described in section 170(b)(1)(A)(vi) of the Internal Revenue Code; a charitable organization described in section 501(c)(3) of the Internal Revenue Code that meets the public support test of section 509(a)(2); OR a charitable organization described in section 501(c)(3) of the Internal Revenue Code that meets the requirements of section 509(a)(3) and is controlled by an organization described in paragraphs (c)(1) (i), (ii), or (iii) of § 1.170A-14 of the Treasury regulations to Internal Revenue Code section 170 (h).
receive recognition of exemption under Section 501(c)(3)\(^3\) of the U.S. Tax Code. Canadian charities are, however, assumed to be "private foundations\(^4\)" under U.S. tax-exempt law, unless further steps are taken by the organization to secure a different type of tax-exempt status (i.e. classification as a publicly-supported charity).

Therefore, to be a ‘qualified donee,’ and thereby be eligible to accept transfers of conservation easements (and other qualified conservation contributions of land), a Canadian land trust must apply to the IRS for a determination that it is a ‘publicly-supported charity.’

Securing and Maintaining U.S. “Publicly-Supported Charity” Status

To receive status as a publicly-supported charity by the IRS, the charity must first already be registered as a charity in Canada.

It must then provide certain details of its funding sources, program availability, and governing documents to the IRS. It must be able to demonstrate that it has a broad base of public financial support as opposed to a private foundation, which is generally funded by a small group of individuals, a family or even one person. A public charity normally receives more than 1/3 of its support each year from a combination of gifts, grants, contributions or membership fees from individuals who are not substantial contributors to the organizations (the so-called "public support test").

The application process involves two steps for the Canadian charity:

1. Obtaining an employer identification number by completing Internal Revenue Service Forms SS-4\(^5\) and
2. Submitting the following documents to the Internal Revenue Service:

   - Copy of its Notification of Registration from the Canada Customs and Revenue Agency (CRA);
   - Part I of Form 1023\(^6\);
   - Part X of Form 1023 which requires a record of funding sources over the last five years (if the Canadian charity was in existence 5 years or more) to demonstrate that the Canadian charity meets the public support test for the 5-year period;
   - Signature line of Part XI of Form 1023; and
   - Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b).

No user fee is currently required.

The formula for calculating the percentage of public support is a complicated formula that requires a series of accounting steps that are generally summarized as follows:

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3 Section 501(c)(3) (U.S) - list of organizations/corporations exempt from taxation under the Internal Revenue Code.

4 Private Foundation — In general terms, a private foundation is an organization described in the Internal Revenue Code 501(c)(3) which does not meet the public support test of Internal Revenue Code 509(a)(1) or 509(a)(2).

5 Employer Identification Number (US) — To apply, the charity must submit Form SS-4: Application for Employer Identification Number. The Internal Revenue Service publication Instructions for Form SS-4 is helpful in completing the application.

6 Application for Tax Exempt Classification (US) — To receive a determination that a charity is not a private foundation, and that it meets the requirements of the public support test for accepting conservation easements, the charity must complete Form 1023.
First, the Canadian charity must determine the month when its accounting year ends (e.g., December) to establish its accounting year (e.g., January 1st through December 31st).

Second, the Canadian charity must identify its sources of support over the applicable period (last 5 years or all of the accounting years it has been in existence), some of which is neither counted toward “public support” (the top of the fraction) nor toward “total support” (the bottom of the fraction) (e.g., “exempt function income”), some of which is only counted toward total support (e.g., gross investment income such as interest and dividends but not capital gain), and some of which is counted toward both public support and total support.

Third, the Canadian charity must identify those donors whose charitable contributions (of land, conservation easements or cash but not in-kind services) count toward public support only to the extent that the total gifts from each donor do not exceed 2% of the organization’s total support over the applicable period (i.e., grants or gifts not from governmental units or other publicly-supported charitable organizations), and the value of their charitable contributions for each of the years during the applicable period.

Fourth, the Canadian charity must apply so-called “attribution rules” that count all gifts from the same family, or businesses related to a major donor, as made by the same person in reaching the 2% limit.

Fifth, the Canadian charity must aggregate (total) the value of all gifts from the same “donor” during the applicable period.

Finally, the Canadian charity must divide the applicable public support by the total support to determine whether or not the public support is a 1/3 or more of the total support during the applicable period.

If the Canadian charity does not meet the public support, it may designate certain grants of land or cash as “unusual grants” if they qualify,7 in which case the grant neither counts toward public support or applicable support, and then recalculate the numbers. In addition, most U.S. land trusts take a “zero approach” to conservation easements donated to them (identifying them but not counting the donor claimed value of deduction toward the public support or the total support), notwithstanding the value assigned to the conservation easement by the donor, under the rationale that the transfer of a conservation easement constitutes a liability as it generally does not provide the land trust with any affirmative rights except to monitor and enforce the conservation easement. Given these complications, the Canadian charity should employ counsel or accountants knowledgeable of the IRS public support test requirements who can help them through the accounting steps before submitting their application to the IRS.

The IRS processing time is anywhere from three months to a year, but the process can be shorter or longer. If the application is missing required information or if the public-support test calculations are incorrectly made or lack transparency, the IRS asks for additional information and documentation after the initial application, which extends the time required for an IRS decision. If the Canadian organization meets the required criteria, it will receive an Internal Revenue Service “determination letter” that clearly states the charity’s tax-exempt status and public support classification.

There may be an annual requirement to maintain charitable status by filing the appropriate version of Form 9908 with the IRS. The charity is also obliged to provide the IRS with a statement, in a timely

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7 “Unusual grants” are grants that are unusual or unexpected in size from donors who are not board members or substantial contributions. See Rev. Proc. 81-7, 1981-1, C.B. 621 for a discussion of the factors that are taken into account in determining if a grant is “unusual” for public-support test purposes.

8 U.S. Income Tax Filing Requirements (US) – Charities receiving U.S. $25,000 or more in a year must file Form 990 Return of Organizations Exempt From Tax for that year to maintain their status as a publicly-supported charity. Further information may be obtained by accessing the Internal Revenue Service website (www.irs.gov). Note—there are various formats of the form. The appropriate form for a particular land trust will vary. Proper advice should be secured by the land trust.
manner, indicating any other material change in the organization’s operations that may affect charitable status.

**Additional Benefits of Publicly-supported Charity Status with the IRS for Canadian Land Trusts and Their Donors**

For Canadian land trusts wishing to accept transfers of conservation easements from AF, IRS determination of Publicly-funded Charity status is essential. But there are other reasons Canadian land trusts may wish to apply for such status.

**Enhanced Income Tax Benefits on Canadian-Source Income**

When a U.S. resident donates a gift directly to a Canadian charity, whether cash or real estate, they may not claim a U.S. tax deduction against U.S. income. However, the Income Tax Treaty between Canada and the U.S. provides for deduction of cross-border charitable contributions and reciprocal recognition of charitable status for Canadian and U.S. charities. This allows U.S. residents to secure income tax deductions against their Canadian-source income reported to the Internal Revenue Service on their annual tax return. There are special rules relating to such gifts.

The default classification as a private foundation provided by the IRS for Canadian charities creates certain deduction limitations for the donors. U.S. residents may claim charitable deductions for gifts to such organizations but they are subject to a 30% of adjusted gross income limit (30% of the donor’s Canadian-source income or 20% for gifts of capital property). Donors can carry forward excess contributions and deduct them in the five subsequent taxation years, subject to the same limitation. As a private foundation, the organization is not listed in the IRS Publication 78, Cumulative List of Exempt Organizations, and is not able to accept gifts of qualified conservation contributions of land (i.e. conservation easements and remainder interests for conservation purposes) without risking serious tax consequences to the donor.

To provide greater benefit to their U.S. donors, a Canadian charity could apply to the IRS for determination that it is a publicly-supported charity and not a private foundation (as discussed above). With such status, the ceiling for deductions is raised from 30% to 50% of adjusted gross income for gifts of cash and from 20% to 30% of adjusted gross income for capital property (or 50% for capital property for which the claimed deduction is limited to the donor’s adjusted basis) or, under a special (time-limited) tax benefit program for qualified conservation contributions.

With such status, the charity will also be listed in Publication 78, Cumulative List of Exempt Organizations (as a foreign organization), which may help donors to feel more confident about making gifts. The charity is then also able to accept gifts of qualified conservation contributions in land (see discussion below).

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9 **Tax Treaty (charity status)** – The Canada-United States Income Tax Convention (1980), paragraphs 5 and 6 of Article XXI. The Treaty, and Notice 99-47 state that all Canadian charities are recognized under Section 501(c)(3), but are assumed to be a private foundation unless they receive an Internal Revenue Service determination otherwise (i.e. recognition as a publicly-supported charity).

10 **Contributions Under Tax Treaty** – Besides being subject to the overall limits applicable to all charitable contributions under U.S. tax law, charitable donations to Canadian organizations are subject to the U.S. percentage limits on charitable contributions, applied to the donor’s Canadian source income.

11 **Step-Down Election (US)**—Under the Internal Revenue Code Section 170(b)(1)(C)(iii)), a U.S. donor may use a "step-down" election to reduce the amount of the contribution of a capital property to the taxpayer’s basis in the property, in order to increase the percentage limitation (percentage of the donor’s adjusted gross income for the year of the gift for which the donor can make deductions) from 30% to 50%. The basis is the acquisition cost plus capital improvement costs, or for inherited land, the value upon inheritance.
**Increased Funding Support**

Classification as a publicly-supported charity and application for an employer number may also be beneficial in helping Canadian land trusts to secure funding support from certain U.S. conservation foundations.

**Enabling Cross-Border Gifts of Conservation Land, Easements and Conservation Remainders**

**Outright Gifts of Land to a Canadian Land Trust**

For outright gifts of land to a Canadian land trust from a U.S. donor, as long as the donee is a registered charity in Canada, the donor is eligible for income tax benefits on Canadian-source income, the gift should be exempt from U.S. gift tax, and the land will be out of the donor’s estate, so estate taxes are lowered as would be expected.

**Bequests of Land to Canadian Land Trust**

For testamentary gifts of land, the gift provides the same U.S. estate tax deductions, regardless of whether the donee is Canadian or American. Limitations apply, however, to the application of the so-called Section 2031(c) special exclusion, which is not available for lands located outside the U.S.

**Donations or Bequests of Partial Interest in Land to a Canadian Land Trust**

As discussed above, U.S. law, however, does not allow a deduction against U.S. source income for a gift of partial interest in property, such as a conservation easement or remainder interest for conservation purposes, unless the gift qualifies as a qualified conservation contribution (see discussion of special requirements for such gifts in the Nova Scotia Nature Trust’s Cross-Border Conservation Gifts Guide available at www.nsnt.ca/afoclt), including the requirement that the donee be recognized the IRS as a publicly-supported charity. Even if the donor wants to grant the easement or other gift of partial interest in land directly to the Canadian land trust and forgo U.S. income tax deduction against U.S. income, there is another potentially very significant issue.

If a Canadian charity is not recognized as a publicly-supported charity by the IRS, U.S. donors of conservation easements and conservation remainder interests may face serious estate tax liability. The reduction in land value attributable to a gifted conservation easement (or other gift of partial interest in land) may not be considered in determining the value of the donor’s estate. Estate tax can be imposed on the entire unrestricted value of the decedent’s property as if there were no restrictions on use and enjoyment of the property. Such a high value for estate tax purposes could mean that heirs would have to sell a cherished conservation property to pay the estate taxes. And, since the restrictions would still be legal under Canadian real estate laws even though not recognized under the U.S. estate tax laws, the resale value could be significantly lower than the estate tax value. Canadian land trusts must be aware of this very serious potential problem for their donors.
Note: To recap--- As discussed above, while all Canadian charities are recognized as equivalent to 501(c)(3) charities by the IRS, classification as a publicly-supported charity, rather than the default 'private foundation' classification can have numerous benefits for donors of cash, land or conservation easements to Canadian land trusts. If granted to a Canadian land trust, however, such gifts only provide an income tax deduction against Canadian-source income.

For a gift to provide an income tax deduction against U.S. source income, the gift must be made to a charity based in the U.S. (such as AF). For a gift of partial interest in land that is also a qualified conservation contribution, to benefit from a U.S. income tax deduction the gift must be made to an organization deemed by the IRS to be a publicly-supported charity. Any subsequent transfers of such gifts from the original charity/donee must also be made to a publicly-supported charity recognized as such by the IRS.

Other Resources:

Technical/background Information on cross-border conservation:


- Guide to Cross-Border Conservation (technical guide to cross-border income and estate tax issues, conservation options and procedures)

Information on American Friends of Canadian Land Trusts and their Cross-Border Conservation Program:

American Friends of Canadian Land Trusts (available at www.nsnt.ca/afoclt)

- American Friends of Canadian Land Trusts brochure
- American Friends of Canadian Land Trusts—Overview for U.S. Donors
- American Friends of Canadian Land Trusts—Overview for Conservation Organizations
- American Friends of Canadian Land Trusts—Conservation Lands Program Overview